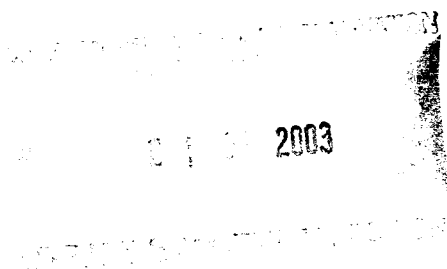




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**CLOSURE AND THE ONE-WAY HIGHWAY IN THE OCCUPIED
PALESTINIAN TERRITORY
UNSCO OUTLOOK 2003**

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Closure and the One-way Highway in the Occupied Palestinian Territory UNSCO Outlook 2003

Closure has played a central part in the creation of a one-way highway in the Palestinian economy; liberalization has played another part. Due to the one-way highway, the Palestinian economy will be hard pressed to absorb the massive numbers of unemployed. Consequently, stabilization and sustainable growth will require not just reconstruction, but economic re-structuring, and demand and far more ambitious aid development program than has been so far envisioned.

Certain elements of the economic decline can be reversed by reconstruction, such as destruction of infrastructure and capital stock. Reducing unemployment, however, will present quite a challenge to the private sector in the new economic environment. The one-way highway has been effected by a combination of Israeli opening of markets under WTO concessions as part of the Paris Protocol on one hand, and the **wall, internal closures** and lack of Palestinian control of their **borders** on the other. The one-way highway has eased the influx of textiles, and closure has enabled foreign and Israeli goods to acquire new access to Palestinian markets as Palestinian producers lost access to their own markets.

The economic decline has occurred across all sectors of the economy, and as the continued deterioration reveals, current emergency aid measures have only slowed the decline—they have not stopped it. Stabilization will be a tremendous challenge once closures are removed. Support for the private sector, however, could drastically improve the likelihood that the economy will absorb the unemployed. Any strategy for the private sector should take into consideration the sustainable employment-generating potential of individual sectors by recognizing which constraints will likely be binding in the aftermath of closure. An understanding of the post-closure environment starts with grasping the magnitude of recent structural change.

Recent Changes in the Palestinian Economy

In 2003, the percent of households below the poverty line reached 63.3% in the West Bank and 83.6% in Gaza Strip according to income-based poverty estimates.¹ Unemployment (and adjusted unemployment²) increased from 14.5 percent (24.9) in 2000 to 25.6 percent (36.3) in 2001, and to 33.7 percent (44) in 2002. Unemployment (adjusted unemployment) stabilized in Q1-2003 at 30.3 (39.3). Stabilization of employment, however, is not indicative of economic stabilization: The Palestinian economy is gradually shifting out of production. With income diminished, those who have lost jobs are struggling to find employment, with many turning to subsistence agriculture and increasingly petty activities in trade and other services. **For the first time ever**, in Q1-2003, the unemployment rate in the West Bank (40.3%) exceeded that of Gaza (37.3%). This can be attributed, in part, to the construction of the separation wall.

¹ Palestinian Central Bureau of Statistics, 2003, this is up from 20.3 percent in 1998.

² Takes into account those who have exited the labor force because they are too discouraged to look for work.

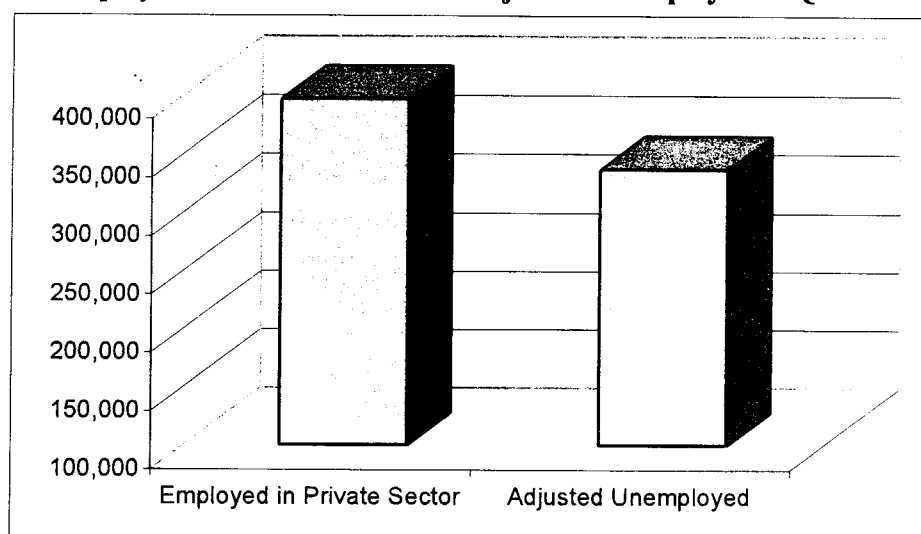
**Unemployment and Adjusted Unemployment in West Bank and Gaza
2000-2002**

	2000	2001	2002	QI-2003
Palestinian Territories				
Standard	14.5	25.6	33.7	30.3
Adjusted	24.9	36.3	44.0	39.3
Gaza Strip				
Standard	19.5	34.1	38.1	28.5
Adjusted	31.9	47.8	48.1	37.2
West Bank				
Standard	12.3	22.0	28.3	31.3
Adjusted	21.0	30.9	38.1	40.3

Source: PCBS, LFS, Various Rounds

Absorbing unemployment in the Palestinian economy will be all the more difficult due to the minimal role played by the private sector. The reduction of employment in Israel, upon which the Palestinian economy grew dependent, and the consequent reduction in domestic jobs under both closure and the one-way highway, has diminished an unstable private sector. Those employed outside the Palestinian Authority are merely 15 percent greater in number than the total number of unemployed.³

Employed in Private Sector and adjusted Unemployed in QI-2003

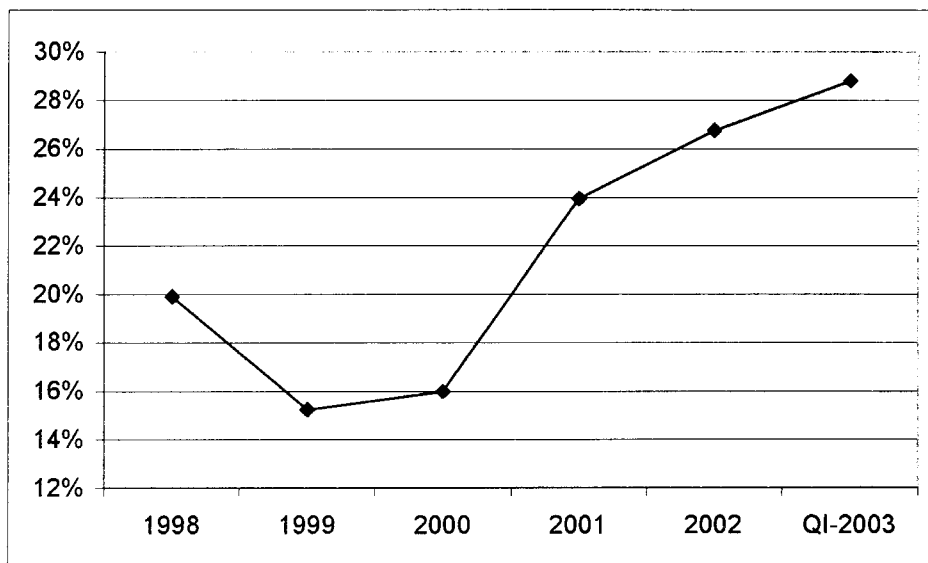


Source: PCBS, LFS, Various Rounds

³ That is, accounting for discouraged workers.

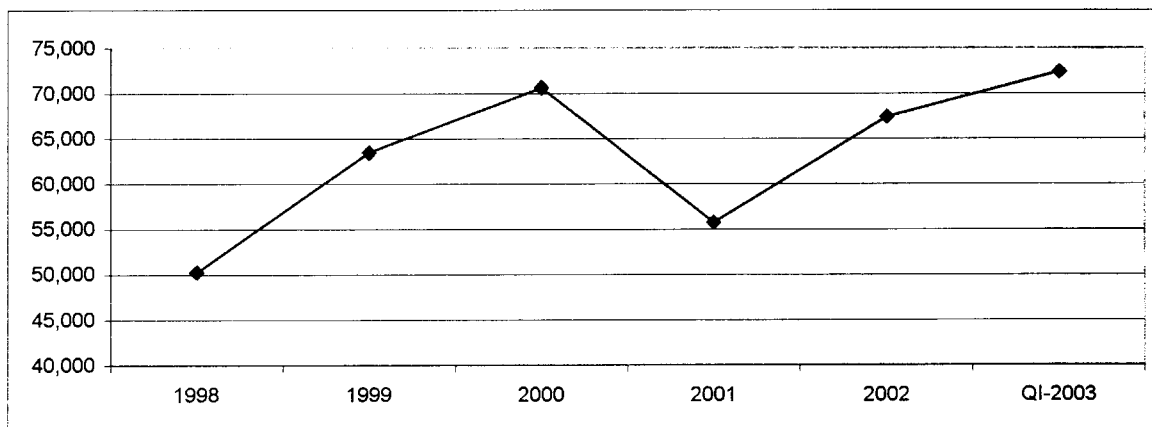
Furthermore, those who are employed are engaged at lower levels of productivity and, therefore, generate less output and less income than prior to the Intifada. As the trend in the graph below illustrates, self-employed are making up more of those actively employed. Similarly, agricultural employment, often the last resort for those in seek of employment, is on the rise.

Self Employed as Percentage of Total Employed 1998-QI 2003



Source: PCBS, LFS, Various Rounds

Employed in Agriculture Domestically 1998-QI 2003



Source: PCBS, LFS, Various Rounds

Forward Looking Sectoral Limitations

In light of recent changes in the Palestinian economy, the likelihood of absorbing unemployed can be sketched according to certain short- to medium-term sectoral limitations. Some preliminary sectoral observations are as follows.

The service sector is a flexible sector that is capable of absorbing unemployed in times of crisis, but it may be fairly limited in the short- to medium-term for two reasons. In the short-term, increases in the supply of many types of services are not necessarily a response to demand, nor do they inject demand. Rather, they merely redistribute current national income. In the medium-term, for services to offer income stabilizing potential, there will have to appear either local or external "motors". External motors depend highly on political circumstances, which, *even under an optimistic scenario of reduced closure*, may not automatically appear. Tourism, for example, is a motor with unparalleled potential for the Palestinian economy, but it can hardly be relied upon to provide jobs in the very near future due to political instability. On the other hand, under circumstances of reduced closure, services that cater to the productive sectors agriculture and industry may offer an important source of employment.

Construction is a sector with substantial multiplier effects. Reconstruction efforts, therefore, may well present unequaled stimulus in the medium-run for the Palestinian economy. However, in order that reconstruction efforts are not merely subjected to Israeli destruction, it may be that such activities will take place in only piecemeal fashion until the crisis has subsided.

The one-way highway to Palestine has made it difficult for stabilization to include a role for small manufactures, which often play an important role in generating low-productivity employment in early stages of developing country growth. However, under circumstances of reduced closure, manufacturing activities that cater to domestic needs in agriculture and construction may find increasing demand outlets as these sectors grow. The current state of Palestinian manufacturing, however, means that some way of directly supporting producers in this sector may be required to overcome market distortions that have led to the majority of activities in this sector to remain low-productivity, sub-contracting to Israeli producers.

Agriculture may have a unique role in the aftermath of closure. Agriculture has many advantages in the post-closure economy, not least because it has played an historically important role and serves to absorb unemployed in times of crisis. There is high level of acquired knowledge in this field due in part to years of working in Israeli agriculture and learning by doing. The agricultural sector has a significant impact on rural areas, women, the poor and especially those that lack other sources of income. However, to the extent that lack of government services and development strategies to this sector reduce profitability, and as a lack of supply of post-harvesting processes and services reduce quality and increase agriculture's inherent risks, the resort to agriculture as a coping mechanism may be expected to merely redistribute income and generate scarce output growth.

Inasmuch as the main priorities of PA are 'sustained economic growth and job creation', an agricultural strategy that improves the profitability of this sector can be seen as

complementary to envisioned needs. This approach would also be line with the PA's vision to 'address the urgent needs of the most vulnerable target groups in Palestine'.⁴ That is because agricultural wages are lower than other sectors, and attract the poor as already mentioned, but furthermore, on a regional level, agriculture provides in the area of twenty-five percent of wage income in certain areas like Jenin, one of Palestine's most vulnerable districts.

Of course, agriculture is a low value-added industry and the benefits of growth may be limited compared with other sectors. In the short-term, agriculture's benefits lay in employment, especially for low skilled sectors of the population—but that seems to be in line with PA objectives.⁵ In the medium term, agriculture can cause demand for non-farm incomes and, therefore, growth in other sectors, by providing a motor for many types of services and manufactured goods.

An economic policy that either ignores agriculture or is limited to agriculture, therefore, can be of limited success. As the economic literature on rural development illustrates, agriculture in rural areas is firstly, an important source of income, but secondly, alone, can rarely generate enough income to raise rural populations out of poverty. Where external motors for non-farm income appear limited, agriculture should be considered an important generator for income and indirectly as a motor for non-farm jobs in manufactures, services and commerce.

In manufactures, there are sorely needed development needs that are linked with agriculture. Currently, the Palestinian manufacturing sector, however, is in a calamitous state, as a result of both lack of development and years of occupation. Before the Intifada, manufacturing was highly dependent on sub-contracting to Israeli markets. Many of those jobs, however, have disappeared and some will never return. As MAS economist Bassem Makhool has recently shed light on, the Nablus garment industry has suffered a near fatal blow. It is unlikely that Hebron's shoe industry is performing much better. Palestinian economist Fadl Naqib, however, has pointed out how (though to perhaps only with great development efforts) manufacturing can find new domestic markets by 'linking' to agriculture.

Clearly, the Palestinian economy is quite limited. Therefore, stabilization efforts will be more likely to succeed where they identify ways of absorbing the unemployed and identifying pockets of sustained demand for output. With some hope, essential restructuring and the complete removal of all closures including the wall and internal closures, and the establishment of border controls, the Palestinian economy can absorb the unemployed, and increase output, productivity and growth.

⁴ See, for example, the recently circulated drafts of ILO/PA Labor of Ministry, *Palestinian Fund for Employment and Protection*.

⁵ Ibid